

7-2500-7892-2
PUC Docket No. G-008/C-91-942

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Complaint of
the Minnesota Alliance for Fair
Competition Against Minnegasco, a
Division of Arkla, Inc.

FINDINGS OF FACT,
CONCLUSIONS AND RECOMMENDED ORDER

The above-entitled matter came before Administrative Law Judge ("ALJ") Richard C. Luis for evidentiary hearings on October 28-29 and November 1-3, 1993 in St. Paul, Minnesota.

The parties to the proceeding are: Minnegasco, a Division of Arkla, Inc. ("Minnegasco", "the Company" or "the Utility"); Minnesota Department of Public Service ("the Department" or "DPS"); Office of the Attorney General, Hubert H. Humphrey III ("Attorney General" or "OAG"); and Minnesota Alliance for Fair Competition ("MAC").

Appearances were made by the following:

For Minnegasco, Paul T. Ruxin, of the law firm of Jones, Day, Reavis & Pogue, North Point, 901 Lakeside Avenue, Cleveland, Ohio 44114. Also appearing on behalf of Minnegasco were Brenda A. Bjorklund and Miggie E. Cramblit, Minnegasco, 201 South 7th Street, Minneapolis, Minnesota 55402.

For the DPS, Scott Wilensky, Special Assistant Attorney General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130.

For MAC, James Larson, Wurst, Pearson, Larson, Underwood & Mertz, 1100 One Financial Plaza, Minneapolis, Minnesota 55401.

For the Public Utilities Commission staff ("MPUC", "PUC" or "Commission") John Lindell and Betsy Engelking, 121 7th Place East, Suite 350, St. Paul, Minnesota 55101-2147.

The OAG did not appear at the hearings or file briefs.

Notice is hereby given that, pursuant to Minn. Stat. § 14.61, and the Rules of Practice of the Public Utilities Commission and the Office of Administrative Hearings, exceptions to this Report, if any, by any party adversely affected must be filed within 20 days of the mailing date hereof with the Executive Secretary, Minnesota Public Utilities Commission, 160 East Kellogg Boulevard, St. Paul, Minnesota 55101. Exceptions must be specific and

stated and numbered separately. Proposed Findings of Fact, Conclusions and Order should be included, and copies thereof shall be served upon all parties.

If desired, a reply to exceptions may be filed and served within ten days after

the service of the exceptions to which reply is made. Oral argument before a majority of the Commission will be permitted to all parties adversely affected

by the Administrative Law Judge's recommendation who request such argument. Such request must accompany the filed exceptions or reply, and an original and

11 copies of each document should be filed with the Commission.

The Minnesota Public Utilities Commission will make the final determination of the matter after the expiration of the period for filing exceptions as set forth above, or after oral argument, if such is requested and had in the matter.

Further notice is hereby given that the Commission may, at its own discretion, accept or reject the Administrative Law Judge's recommendation and that said recommendation has no legal effect unless expressly adopted by the Commission as its final Order.

STATEMENT OF ISSUES

In its May 5, 1993 Notice and Order for Hearing ("May 5 Order") the Commission required the following issues be addressed:

1. Under the Company's current cost allocation practices, do its regulated operations subsidize its appliance sales and service operations?
2. If subsidization is occurring, what steps should be taken to end it and ensure that it does not recur?
3. Will the application of FCC cost allocation principles make the Company's cost allocations comprehensible to and auditable by outside parties? If not, what s
4. Is the Company's winter gas leak detection program prudently designed and operated? Are the costs properly allocated?
5. The Commission also provided that the parties could address "other

issues related to allocating costs between the Company's regulated operations and its unregulated appliance sales and service business." May 5 Order, p. 3.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Procedural_History

1. The background to the current proceeding involves resolution of complaints by the Minnesota Alliance for Fair Competition alleging unfair competition by Minnegasco. MAC alleges that the regulated utility operations subsidize the unregulated appliance sales and service businesses unfairly and to the detriment of MAC members. MAC is an organization of trade associations representing independent plumbing, electrical and appliance sales and service entities that compete in Minnesota with Minnegasco's unregulated appliance sales and service operation.

2. The issue was first raised in MAC's petition to intervene in Docket No. G-009/PA-90-604, In_the_Matter_of_the_Proposed_Merger_of_Minnegasco,_Inc. with_and_into_Arkla,_Inc. In its September 14, 1990 Order, the Minnesota Public Utilities Commission found that MAC's concerns should be addressed outside of the Minnegasco/Arkla merger docket.

3. On January 4, 1991, the Commission issued its Order_Initiating_Investigation_and_Requiring_Report in Docket No. G,E-999/CI-90-1008. On May 6, 1991, the Commission issued an Order_Requiring_Further_Filings_and_Investigation. In that Order, the Commission expressed concern regarding the allegations of utility cross-subsidization and impropriety raised by MAC. After a comment period, the Commission issued an Order requiring each utility to file cost separation data and a proposed customer brochure explaining the differences between its regulated and unregulated services. The Commission expressed concern regarding possible discrimination and stated that the use of a regulated utility service in a preferential manner would be directly against Commission and public policy.

4. On November 27, 1991, MAC filed a complaint against Minnegasco, a regulated gas utility. Among other things, the complaint alleged that Minnegasco subsidizes its unregulated appliance sales and service operations through its regulated utility operations.

5. On January 29, 1992, the Commission issued an Order removing Minnegasco from the ongoing investigation of all utilities' appliance sales and service operations (Docket No. G,E-999/CI-90-1008) and establishing this complaint docket. The Order consolidated all of MAC's concerns regarding Minnegasco that were formerly addressed in the 1008 docket. The January 29,

1992 Order also granted MAC discovery rights and required MAC to file a report on the results of its investigation, which it did on June 12, 1992. Minnegasco, the DPS and the OAG filed comments.

6. On September 28, 1992, Minnegasco filed a Motion to resolve the complaint. The Motion requested that all cost allocation issues be dealt with in the Company's ongoing rate case pursuant to the Commission's August 17, 1992 Order_Accepting_Filing_and_Suspending_Rates. The Company argued that any other allegations by MAC had been dropped or were unsubstantiated.

7. On November 10, 1992, the Commission issued an Order_Establishing_Accounting_Procedures_And_Requiring_Further_Filings. In that Order, the Commission ordered Minnegasco to adopt cost separation principles developed by the Federal Communications Commission ("FCC"). The November 10 Order also required Minnegasco to charge the cost of carbon monoxide ("CO") checks to unregulated operations and to make a filing regarding its winter residential gas leak detection program and various allocation issues. On November 30, 1992, Minne

8. On January 20, 1993, MAC filed its response to Minnegasco's November 1992 report alleging a subsidy of \$12.4 million to the Utility's unregulated sales and service operations during the calendar year 1991. On February 8, 1993, the Commission issued its Order_After_Reconsideration clarifying its November 10, 1992 Order with respect to a finding of no preferential treatment, limiting that finding solely to the Company's gas installation scheduling practices. The Order found that the Company's cost allocation procedures required improvement.

9. On December 18, 1992, prior to any responses to its November 30, 1992 filing, Minnegasco filed a motion requesting a contested case proceeding. On April 22, 1993, Minnegasco's compliance filings, and the other parties' comments on them, came before the Commission. MAC contended that Minnegasco had failed to implement FCC allocations properly and that its regulated operations continued to subsidize its appliance sales and service operations by some \$12.4 million per year. MAC urged structural separation of Minnegasco's regulated and unregulated operations.

The DPS recommended that the Commission initiate contested case proceedings on cost allocation issues and requested accelerated treatment to allow the decisions in this docket to be incorporated into Minnegasco's next rate case.^{1/} The OAG concurred, as did Minnegasco.

^{1/} On December 12, 1993, the Commission voted to accept Minnegasco's General Rate Case file, effective December 9, 1993.

10. On May 26, 1993, the Administrative Law Judge (ALJ) convened a

prehearing conference. On June 28, 1993, a Prehearing Order was issued setting forth the schedule of the proceedings and the order of filings. Due to problems in discovery, the filing schedule and the hearing date were amended.

11. On August 4, 1993, portions of two motions to compel discovery brought against Minnegasco by MAC were certified to the Commission. Also certified was the issue of whether evidentiary hearings should be limited to considering the allocation methodologies and accounting practices used by the Company since July 1, 1993, as Minnegasco contended. In its Order dated September 20, 1993, the Commission agreed with the ALJ's conclusion that examining these issues requires a frame of reference and historical context much more comprehensive than post-July 1 data alone can provide. The Commission ruled that it would be inappropriate to limit this proceeding in such a manner.

12. On September 14, 1993, the ALJ issued Orders_on_Motion_to_Compel_Discovery_and_Order_Certifying_Portions_of_Motion. The Motion sought information regarding the actual cost allocations of Arkla, Inc. On October 7, 1993, the Commission issued an Order that agreed with the ALJ's ruling that the information sought by MAC improperly broadens the scope of these proceedings. The Commission found that while Arkla's allocations to its various divisions are within the scope of the Commission's regulatory inquiry, they are not, for the most part, germane to these proceedings, which are to investigate Minnegasco's allocations and not the allocations made to it by Arkla.

13. Minnegasco filed Direct Testimony on July 2, 1993. MAC and the Department filed Direct Testimony on September 22, 1993. Minnegasco filed Rebuttal Testimony on October 18, 1993, and both MAC and the Department filed Surrebuttal Testimony on October 26, 1993. Evidentiary hearings began on October 28, 1993, and concluded on November 3, 1993. Eight witnesses were presented for cross-examination. No public hearings were conducted.

Ratepayer_Subsidy_of_Unregulated_Operations

Introduction

14. Because of its concern that regulated operations not subsidize unregulated operations and the need to "replace existing ad hoc allocation procedures with a cohesive and comprehensive approach", the Commission ordered Minnegasco to "adopt and implement the cost allocation principles developed an

15. The Commission's repeated reference to the need for "a cohesive and comprehensive approach", its adoption of the "comprehensive cost allocation framework" of the FCC and its directive to Minnegasco to adopt and implement cost allocation principles as "developed and applied" by the FCC (November 10 Order, pp. 4, 7, 10) made it necessary for Minnegasco to refine "its cost apportionment methodology to comply as fully as possible with the applicable FCC methodology." Ex. 18, p. 14.

16. The Commission's May 5, 1993 Order set out several possible

approaches for resolving MAC's Complaint. The first issue was to determine if, under the Company's current cost allocation practices, regulated operations subsidize its appliance sale and service operations.

17. On January 20, 1993, MAC filed a Report with the Commission in this docket. The Report was prefiled subsequently in the contested case by agreement of the parties and became MAC Ex. 40 and 41. MAC 40 identified a subsidy of appliance sales and service by the regulated utility of \$12.4 million for 1991, consisting of a subsidy of \$11 million of the appliance service business and \$1.4 million of the appliance sales business. MAC Ex. 40

at 17. MAC updated its analysis of the subsidies in its Direct Testimony, showing a subsidy of \$11.9 million in 1991 and \$10.3 million in 1992. MAC Ex.

24 at 8 and 18 (Fietek). MAC presented its subsidy analysis in four major categories of expense: direct labor costs, other labor-related costs, customer-related costs and general and administrative (G & A) expenses. Each of these major categories of expense had component parts or sub-categories of expense.

18. The issue of past subsidies is problematical due to Minnegasco's change in its cost allocation practices on July 1, 1993. First, it is difficult to make a comparison of the level of costs allocated under the new method compared to previous methods. More important, while this comparison is

informative, it does not prove the existence of subsidy under a prior method. Rather, it may point out weaknesses in Minnegasco's cost allocation system. Because the issue of prior subsidies will not affect future rates, it is appropriate to determine whether the allocation system being used since July«1,

1993 can report information in a manner that makes the Company's books and records comprehensible and auditable to outside parties. If this can be done,

then the next step is to examine the specific allocation methodologies to determine if they are reasonable.

Compliance_with_Applicability_of_FCC_Principles

19. Sound cost allocation techniques are essential regulatory tools for ensuring that rates for utility service are just and reasonable. Ex. 1, pp. 5-6.

20. The FCC principles create a hierarchy to guide cost assignment choices, structured to force recognition of cost causation as the ultimate determinant of allocations. Ex. 28; Ex. 18, pp.«10-11.

21. The FCC chose a fully allocated approach to apportioning costs between regulated services and non-regulated activities. In doing so, the FCC

acknowledged that this approach went beyond satisfying concerns about cross-subsidy, allowing for participation by ratepayers in available economies of scale and an equitable sharing of the benefits of combined operations. Ex.

1, pp. 12-13.

22. Under the FCC's fully allocated cost approach, all costs are apportioned into categories based on either direct or indirect measures of cost. Ex. 1, p. 10.

23. Section 64.901 of the FCC rules contains applicable principles which can be summarized as follows:

Whenever a non-regulated activity uses a tariffed service, it is to be charged the tariff rate. Costs incurred exclusively for either regulated services or non-regulated activities are to be directly assigned whenever possible.

Common costs are to be grouped into homogenous cost pools and attributed to

Residual costs for which no direct or indirect measure of cost causation can be identified are to be apportioned between regulated services and non-regulated activities based on a "general allocator." The general allocator is based on the regulated/non-regulated ratio of all expenses which can be directly assigned or attributed.

FCC principles associated with telecommunication-specific issues only are not applicable.

24. Minnegasco followed not only FCC principles, but also relevant and applicable FCC rules and guidance. In selecting factors, Minnegasco considered a decision tree approach, Ex. 2, Sched. 1, and the following factors to select cost apportionment methods:

Specific FCC guidance which requires a cost category to be apportioned using a particular method which is equally applicable to Minnegasco's operations. FCC guidance can take the form of rules as well as orders directed at all or individual companies.

Availability of direct measures of cost causation.

Indirect or secondary measures of cost causation which serve as reasonable proxies for direct measures of cost causation.

The practicality and feasibility of performing direct measures of cost causation.

The materiality of the cost category involved.

Ex. 2, p. 4.

25. Minnegasco also adopted the following apportionment factor characteristics set forth by the FCC in Docket No. 86-111, released February 6, 1987, in developing its apportionment philosophy:

The apportionment factor has a reasonable relationship to the cost to be apportioned.

The apportionment factor is efficient to use in terms of both time and costs.

The method used to determine the apportionment factor would be consistent year-to-year, unless there is a significant change in the nature of the operations. Ex. 18, pp. 18-20.

26. The DPS recommended that FCC principles be considered in developing the Company's cost allocation system. The ALJ finds that it is also appropriate to follow the applicable and relevant FCC rules and guidance to avoid an ad hoc system of cost allocations and to avoid the expense of creating a new allocation system. November 10 Order, p. 7. This approach does not limit the parties' right to challenge the appropriateness of applying particular FCC guidance or restrict the Commission's authority; rather, it provides a disciplined, systematic way to allocate costs. Tr. Vol. 1, p. 157. Such an approach also heeds Minnegasco witness Farmer's warning that "This proceeding must never be allowed to degenerate to the point where the debate centers not on what the most appropriate apportionment methodologies are, but instead on how much or how little cost they apportion to non-regulated operations." Ex. 2, pp. 15-16.

27. Department witness Helmuth Schultz conducted discovery and an on-site investigation of Minnegasco's July 1993 financial results. He concluded that two changes made by Minnegasco assist in auditing and tracking its allocation procedures. The first is the compilation of a Cost Allocation Manual (CAM). The Manual makes it easier to determine Minnegasco's apportionment methodology.

DPS Exh. 30, p. 43. In addition, he found that the establishment of separate accounts which capture costs for apportionment aids in the process of tracking costs to the specific regulated and non-regulated Federal Energy Regulatory Commission (FERC) accounts. Id.

28. However, Mr. Schultz raised concerns regarding the auditability of the Company's books and records. A major concern from an auditing standpoint is Minnegasco's ability to generate reports which permit a "top-down" audit. As Minnegasco witness Farmer testified, the ability to perform a top-down audit is important

29. Mr. Farmer testified that it is preferable and in fact "normal procedure" to work with annual information. Minnegasco could not provide this type of information for prior years on an annual aggregate basis. While Mr. Farmer did not believe failure to provide such information would require the extreme sanction of a qualification of an audit opinion, he did believe that it would make setting the scope of the audit more difficult and is something he

might raise in the auditor's management letter which explains concerns of the auditors to management. Tr. Vol. 1, pp. 121, 124-125.

30. This type of top-down information is necessary in conducting a rate case audit. Minnegasco witness Hagen testified that under the new accounting system, the annual information referred to by Mr. Farmer for purposes of a top-down audit would be available. Tr. Vol. 2, p. 385. However, he also indicated that it would be difficult for the Company to provide annual information for pre-July 1, 1993 data. Id. Thus, there remains a concern with the ability to appropriately audit relevant accounts and allocation information in the Company's rate case. However, the ALJ finds that on a going forward basis, if the Company can provide the information which Mr. Hagen and Mr. Farmer claimed could and should be provided, parties will be able to conduct top-down audits in the future.

31. Certain FCC concepts cannot be applied directly to a natural gas company. Minnegasco followed relevant and applicable FCC rules and other guidance. Ex. 1, pp. 16-17. The two sections of the FCC rules which contain principles relevant and applicable to Minnegasco are 47 CFR Sections 64.901, Allocation of Costs, and 64.903, Cost Allocation Manuals. Ex. 1, pp. 15-18; Ex. 28.

32. Minnegasco was unable to use the FCC's chart of accounts since it is required by the Commission to follow FERC's chart of accounts; therefore, it properly used its responsibility accounting system as the starting point to facilitate compliance with the FCC since it provided the "necessary costing information." The relationship between Minnegasco's responsibility accounting system structure and the FERC chart of accounts is shown in an appendix to Minnegasco's Cost Apportionment Manual ("CAM"). Ex. 1, pp. 17-19; Ex. 18, pp. 14-15 and 23-25. It was proper for Minnegasco to create a CAM and, in fact, the creation of a CAM was required in accordance with 47 CFR Section 64.903. Ex. 28; Tr. Vol. 1, p. 155. Further, Minnegasco's CAM complies, in form and content, "with relevant and applicable FCC rules." Ex. 1, p. 20.

Auditability_of_Minnegasco's_System,_Internal_Controls

33. Pursuant to its investigation in this docket, the DPS points out several errors made by the Company in an attempt to comply with the Commission's Orders. A significant error discovered by the Department's investigation is Minnegasco's inaccurate count of the Winter Residential Leak Surveys (WRLS). The Company claimed initially that it reported 110,000 surveys for 1992 but that the actual number was more like 90,000. See DPS Exh. 46, p. 5, Sch. FL-3. Later, the Company determined that the most accurate number was roughly 79,000. See, MAC Exh. 25, Sch. 1. This represents a reporting error of 38 percent. While Minnegasco witness Holmstoen testified that the problem was corrected, (Tr. Vol. 2, pp. 308-309), the fact that such significant overreporting could occur without some internal control catching it is a

serious concern going beyond the WRLS issues. The ALJ finds that the Company should take action to ensure that its reporting procedures are subject to appropriate internal controls so that errors can be detected and corrected.

34. Another error that will stem naturally from the implementation of a new system is miscoding of expenses. DPS Witness Schultz found a July invoice incorrectly charging an expense related to this docket (which the Company believes should be allocated based upon the general allo

35. Minnegasco's application of exception time reporting is another example of a problem found in its accounting or cost allocation procedures. Minnegasco's Cost Allocation Manual states that exception time reporting should be used when employees who do not use positive time reporting perform unusual or out of the ordinary tasks.

36. In Mr. Hagen's rebuttal testimony, he identified roughly 1300 of the 2000 hours of exception time reporting as "normal" exception time. Minnegasco Exh. 20, pp. 23-25. Tr. Vol. 2, p. 400. Meter readers accounted for 60 percent of all exception time for performing the ordinary function of meter reading. These anomalies will tend to mislead the auditor with respect to the extent of true exception time reporting. Thus, the ALJ finds that the Company should attempt to change its reporting so that this "normal" exception time is not reflected as exception time. If this cannot be done, the Cost Allocation Manual should identify cost centers which will report a large amount of what the Company considers "normal" exception time and assure that its records can easily demonstrate the total exception time charged, the amount considered as "normal" exception time, and the accounts into which the remainder is charged. This will ensure that proper scrutiny of true exception time reporting can occur.

37. Another concern is that allocations are updated in a timely manner and that certain accounts actually are trued-up at the year's end. The Company identified all of the apportionment factors that would be changed and the frequency of the change that will occur. See DPS Exh. 36, Sch. 31. While this indicates that the Company intends to update information, there are still potential problems. Several of the apportionment factors are intended to be trued-up on an annual basis. It is unclear whether the Company has the capability to make year-end dollar true-ups to various apportioned costs. For example, if Appliance Service Technician Minutes are budgeted at a 70 percent non-regulated and 30 percent regulated split, this allocation will be made on a monthly basis. It is uncertain how the Company would then calculate the true-up at year-end to total service technician dollars if the actual ratio for the year turns out to be 75 percent to 25 percent. These dollars will have

been booked to FERC accounts on a monthly basis, and the Company identified no procedure for how the costs will be aggregated to make the year-end split. This same concern is heightened when the apportionment method is tiered. It is difficult to determine how the system can true-up amounts that have been allocated on the basis of multiple allocators. DPS Ex. 36, p. 7.

If an adjustment is made that affects the direct labor of service technician minutes, or if the annual true-up charge is significant, it is found that the financial impact of either event should either be run through all cost centers using service technician minutes as part of the apportionment method or easily estimated, so as to accurately reflect the annual financial results of both regulated and nonregulated operations.

38. Minnegasco attempted to rely heavily on FCC precedent. DPS witness Schultz examined Minnegasco's allocation methods with respect to their reasonableness based on the FCC hierarchy. Tr. Vol. 4, p. 598. He did not attempt to identify FCC precedent regarding the various apportionment factors other than the general allocator. The reason that the general allocator was examined in this manner is because the FCC principles specify how the general allocator is to be calculated. All other elements of the hierarchy are simply broad principles which should be applied in a reasonable manner. MAC witness Fietek did not rely on FCC precedent but rather the general principles of a fully distributed cost study. In reviewing the Commission's November 10, 1992 Order requiring Minnegasco to adopt FCC cost allocation principles, the ALJ finds that the Com

39. The overriding principle of the FCC hierarchy is to assign expenses directly whenever possible. DPS witness Schultz reviewed Minnegasco's payroll allocations and found that approximately 66 percent of the employees within the Company have their labor expense distributed based upon a fixed allocation factor rather than directly assigning these costs through use of positive time reporting. DPS Exh. 30, p. 24. The ALJ finds that the Company should continually review its ability to assign costs directly such that fixed apportionment methods are allocating fewer dollars.

40. In evaluating the appropriateness of any direct or indirect method of attribution, it is appropriate to attempt to find methods that are most likely to reflect the actual work function rather than some theoretical relationship. Had positive time reporting been used, it would be the actual work activity that drives the allocation factor. Thus, it is appropriate to focus on the actual work activity in determining allocation methods.

41. Finally, the parties agree that there is no one right method of allocating costs. Minnegasco Exh. 2, p. 3; DPS Exh. 36, p. 7. Expert witnesses can disagree with respect to the appropriateness of given allocators.

The Commission must ultimately decide which factors it believes are most

reasonable. The Commission should not, as Minnegasco witness Farmer suggests, simply review the apportionment methods and determine that overall they are reasonable. In a situation where rates are affected, it is appropriate for the Commission to engage in reasoned decision-making regarding all disputed issues.

42. With respect to the concerns noted above, Minnegasco maintains that its CAM is both understandable and complete. Ex. 1, pp. 21-24. It believes the logical progression of the allocation process can be readily understood since any item of expense (or any capital expenditure) can be traced through the process. Ex. 1, pp. 21-25. Minnegasco established separate accounts to capture total costs and further assigned separate FERC account numbers to each cost pool, making it possible to trace source transactions through the cost apportionment process to reported results. The cost pools for each cost center and the FERC numbers assigned were included in Minnegasco's CAM to simplify the tracing of costs both from the departments incurring the costs to the FERC accounts and from the FERC accounts back to the departments incurring the costs. Ex. 18, pp. 40-41. No party disputed these facts.

43. Consistent with the FCC hierarchy, Minnegasco's CAM requires that costs be directly assigned to the extent possible, then assigned to cost pools which are themselves assigned based first on direct, then on indirect cost-causation factors. Only when these approaches have been exhausted are remaining costs allocated using a general allocator calculated according to FCC principles. Ex. 19; Ex. 1, pp. 10-12; Ex. 18, pp. 10-11; Ex. 19. Since the general allocator is only used when costs cannot be directly assigned or apportioned based on direct or indirect cost causative factors, an indication of the effectiveness of the cost allocation system is the percent of total costs subject to the general allocator. Tr. Vol. 1, p. 172. In the FCC's original order, its expectation was that less than 10% of total costs would be subject to the general allocator. Tr. Vol. 1, p. 172. Minnegasco's general allocator has been applied to less than 2% of Minnegasco's total costs, excluding the cost of gas, evidencing the system's effectiveness. Tr. Vol. 3, pp. 532-33.

44. Auditability is determined by a review of the cost apportionment methodologies to determine whether they comply with FCC principles and guidance and whether each methodology is supported by an audit trail sufficient to enable a third party to trace and test transactions from their "origin through reported results." Ex. 1, p. 21.

45. The DPS and Minnegasco agree that Minnegasco's question. Ex. 24, p. 41. In response to MAC's arguments regarding the lack of an audit, Minnegasco maintains that its decision to conduct such an audit

following PUC approval of its cost allocation methodology is reasonable. It is found that it is not necessary to perform an audit to determine that a CAM is auditable. Ex. 2, p. 20.

46. The DPS asserts that the fact that Minnegasco's CAM has only been in effect for one month constitutes a "basic weakness" of the CAM. The Company argues that the audit of a single month's results as produced by Minnegasco's apportionment system is more than sufficient to verify that an audit trail exists, especially since the first evaluation of any cost apportionment manual must be a determination that the stated methodologies are in compliance with applicable FCC principles and other guidance. After Commission review and approval of a manual, a second evaluation is then appropriate to determine whether the methodologies it contains have been implemented and appropriate results produced. The first evaluation must not be "results driven" because it could impair the integrity of the evaluation of cost apportionment methodologies. A two-step evaluation process complies with FCC practice. Ex. 2, pp. 14-16.

47. Minnegasco provided detailed testimony evidencing numerous different internal control procedures. It is found that sufficient controls exist to minimize errors in cost reporting. Ex. 18, p. 30.

Minnegasco provided detailed testimony evidencing that it has provided and will continue to provide proper training to employees regarding use of its CAM.

In response to MAC criticism on this point, the Company established that its initial training materials were sufficient, particularly since they were used in meetings where the written material was explained in detail and where questions on implementation were answered. Materials were not simply sent to the users with no further explanation. In addition, various accounting employees were identified as resources for employees to call with questions. Ex. 20, pp. 59-61.

48. Minnegasco and the DPS have agreed to work together to design and create "top-down" reports necessary to audit Minnegasco's system efficiently. Ex. 20, p. 46. Minnegasco is also willing to work with the DPS to design a reasonable process for notification and documentation of any changes to the CAM. Such changes may result from newly created cost centers, changes in operations, changes as a result of regulatory proceedings and corrections to the CAM. Ex. 20, pp. 56-58.

Past_Subsidies,_MAC's_Proposal_to_Sever_Unregulated_Operations

49. Minnegasco proposed that the appropriate test to determine the existence of a subsidy is an incremental cost analysis. That is, if costs of regulated operations increase due to the existence of non-regulated operations, then a subsidy would exist. If, however, the regulated operation is charged no

more than those costs which would be incurred to provide utility service, whether or not a non-regulated function existed, then no subsidy exists. Ex. 20, pp. 49-50.

50. In developing its final cost allocation principles, however, the FCC adopted its fully allocated cost system, which went beyond what was necessary to prevent cross-subsidy and allowed participation by ratepayers in available economies of scale and an equitable sharing of the benefits of integrated operations. FCC Docket No. 86-111 (February 6, 1987), paragraph 109; Ex. 1, pp. 9-10. Proper implementation of the FCC principles will go beyond preventing cross-subsidies:

"The FCC rules require that all costs associated with non-regulated activities based on cost causation are to be segregated from the costs of regulated services, addressing cross-subsidy concerns. The rules further mandate that a portion of the common costs of the company be apportioned to nonregulated activities; an addit

Ex. 1, p. 13.

51. It is found that CAM methodology of Minnegasco, properly applied, should not permit the existence of any cross-subsidies.

The Company argues that MAC's calculations and allegations of subsidies existing under Minnegasco's prior methodology in 1991 and 1992, even if true, are irrelevant since Minnegasco's prior methodology was abandoned by order of the Commission. November 10 Order, p. 7. The ALJ does not agree. MAC's allegation of \$20 - \$25 million in subsidies for 1991-1992 is significant enough, especially in light of MAC's argument that it is too early to tell if the Company's new allocation system can prevent future subsidies, for the Commission to consider ordering Minnegasco to sever its regulated and non-regulated operations. With this in mind, the Judge will make Findings regarding past subsidies.

52. The Company argues that MAC's allegation that Minnegasco subsidized its appliance operations in 1991 and 1992 is unfounded. It points out that while costs apportioned to the non-regulated operations using the FCC methodology will increase over those apportioned in 1991 and 1992, that does not mean a subsidy existed previously. Ex. 20, pp. 50-51. Because there is no single "right" apportionment method or factor, it is reasoned that the fact that one method apportions more or less than another does not mean that a subsidy does or does not exist. Ex. 20, p. 51.

53. MAC witness Fietek agrees with the Company that a change in cost allocation methodology and result does not of itself prove the existence of a subsidy under either of the two methods being compared. Tr. Vol. 3, pp. 546-547. This point is further illustrated with late-filed Exhibit 54, which compares expenses and income in July-September of 1992 under the old allocation system with results of July-September of 1993 under the current allocation system. MAC alleges that the differences prove a subsidy. It is found that this argument is misplaced. Business conditions, prices, and monthly variations in reported activity explain most of the differences. Ex. 54, Ex.

C, p. 3. More importantly, the change in methodology necessarily produced a change in reported results. This is not evidence of a subsidy, only of a change in methodology.

54. In its January 20, 1993 Report (which was the basis for the revised 1991 and 1992 allegations of subsidy), MAC specifically alleged that Minnegasco understated its non-regulated costs by \$12.4 million in 1991. In response, Minnegasco provided detailed testimony attempting to refute this allegation dollar by dollar. As Minnegasco testified, of the \$12.4 million total:

(a) \$.6 million (\$881,000 less taxes and benefits) related to CO checks,

winter residential leak surveys ("WRLS") and "miscoded" jobs - all of which were properly accounted for by Minnegasco.

(b) Regarding CO checks, Minnegasco properly removed the cost of CO checks from regulated operations and also removed these costs in Minnegasco's 1992 rate case in accordance with the Commission's November 10 Order. Until that time, CO checks were a proper cost of utility operations. The utility is not currently being charged for any cost related to CO checks. Ex. 18, pp. 57-58.

(c) Regarding WRLS, MAC's witness agreed under cross-examination that the costs of a properly designed program could be charged to the utility. Tr.

Vol. 3, p. 550. Subsequent findings will detail why MAC failed to demonstrate that the WRLS was designed imprudently. The Company argues that MAC's dispute with the 10-minute time period used to charge utility operations for these surveys is moot since Minnegasco has testified that it will track actual time spent performing WRLS. Minnegasco also challenged the method contained in MAC's January 20, 1992 report purporting to show that Minnegasco's WRLS takes less than 10 minutes to perform since MAC was essentially com

(d) Regarding "miscoded" jobs, Minnegasco argues that MAC ignored the cost-causative factor - the nature of the work performed - and incorrectly

assumed that any time an appliance was involved, time worked must be coded

as non-regulated. It points out that work done in response to gas leak calls, relighting appliances after an outage or repair, conversions or new

customer hook-ups to natural gas, and other utility work accounted for 100% of the allegedly miscoded technician time. Ex. 18, pp. 65-67.

MAC's suggestion that "turning-on" an appliance is not a utility function because Minnegasco's tariff terminates company responsibility at the meter

is misplaced. The turn-ons referred to by Minnegasco are those after "system outages or repairs," not after appliance repairs. Ex. 18, p.

66. Turning-on service after a system outage or repair is a utility function and the cost of doing so is a utility cost, not a subsidy of the appliance business.

(e) \$ 1.2 million related to changes in the ratio of regulated productive appliance service technician time to total productive time from 68.64% to 81.10%. MAC's changes were based on the CO check, WRLS and "miscoded" jobs along with the impact of a 482,132-minute misclassification of non-productive time in 1992. Minnegasco points out it previously corrected the 482,132-minute error (quantified at approximately \$205,000) in its 1992 rate case and argues the other adjustments are erroneous for the reasons discussed above. Ex. 18, pp. 69-72.

(f) \$ 2.6 million related to "customer related" costs which MAC alleged were either not apportioned or not properly apportioned. Of this \$2.6 million amount, approximately \$600,000 related to Minnegasco's cashiering and inserter operations. As detailed in its testimony, Minnegasco allocated such costs to its non-regulated operations. Additionally, Minnegasco properly apportioned costs from eight customer-related departments to Appliance Sales and Service in 1991. Ex. 18, p. 52.

(g) The additional \$2 million in customer related costs which MAC would apportion to non-regulated operations are, in fact, related only to utility functions as demonstrated by Minnegasco. Ex. 18, pp. 74-76.

This portion of the subsidy claim by MAC is without merit since MAC's only basis for it, as testified to by Mr. Fietek, was his "personal belief" that these customer related costs should be apportioned to non-regulated operations. Tr. Vol. 3, pp. 563-64. Further, MAC's proposed use of a single apportionment factor (number of customers) to apportion these costs fails to comply with FCC principles. Ex. 18, pp. 75-77.

(h) \$ 8.0 million related to general and administrative costs. MAC proposed that all such costs, which vary greatly in nature, be apportioned using a single apportionment factor (some form of general allocator) based on either number of employees or supervised expenses. Since a general apportionment method is to be used only when there is no other method available, this is a clear violation of FCC principles requiring that costs be apportioned using a cost causative approach. Contrary to Mr. Fietek's testimony, the general allocator may not be used as an alternative method of indirect attribution. Tr. Vol. 3, pp. 562-63.

(i) In its computation of a general allocator using number of employees, MAC's calculation of regulated and non-regulated employees was erroneous, as Minnegasco detailed in testimony. Ex. 18, pp. 84-85. Further, its computation of a general allocator using supervised expenses failed to comply with FCC principles since general and administrative expenses, interest, depreciation and taxes were improperly excluded. Ex. 18, pp. 77-86; Tr. Vol. 3, p. 556.

(j) Incorrect calculatio

(k) The FCC principles require that the general allocator only be applied

"when neither direct nor indirect measures of cost allocation can be found. . . ." Ex. 28. The vast majority of the \$28 million of general and administrative expenses were, consistent with the FCC requirements and

the nature of the costs, directly or indirectly assigned by Minnegasco. Ex. 18, pp. 77-79; Tr. Vol. 3, pp. 558-61. The result was that MAC incorrectly used the general allocator to assign general and administrative costs that had previously and properly been directly or indirectly assigned. It is found that Minnegasco has refuted MAC's allegations of subsidies for 1991.

55. MAC also quantified subsidies for 1992. The MAC analyses and rationale for its 1992 quantification was the same as it used for 1991, except that MAC made no adjustment for CO checks or the Arthur Anderson adjustment. Based upon the same rationale it used to support its allegations of subsidies in 1991, MAC concluded that Minnegasco subsidized its appliance sales and service operations in 1992 in the total amount of \$10,294,345. This total consists of direct cost subsidies (\$298,009 related to Leak Checks, \$173,765 related to "Miscoded Jobs"); Productive Labor-Related Costs of \$869,986; Customer-Related Costs totaling \$2,581,044; and General and Administrative Expenses of \$6,371,541.

Minnegasco rebuts the allegations of subsidies for 1992 in the same fashion it did for 1991, and it is found that the Company has refuted MAC's allegations of subsidies for 1992.

56. MAC listed a number of intangibles used by Minnegasco's non-regulated operations which it alleged resulted in subsidies by the regulated operations. However, as Minnegasco testified, the items listed by MAC cannot contribute to the existence of a subsidy because these items impose no costs on utility customers. None of these items can be recorded as assets on Minnegasco's books and are not included in its rate base; there is no cost to regulated operations which could result in a subsidy or which could be assigned to non-regulated operations and, in fact, "goodwill" advertising has not been allowed as a cost in setting rates. Ex. 20, p. 52. Utility rates are based only on recognized costs of service including return on rate base, and none are associated with items listed by MAC. Ex. 20, p. 52.

57. The value of such intangibles is distinctly and exclusively the property of Arkla's shareholders, who bought and paid for these "other intangibles" by paying a premium over the rate base value on which Arkla is allowed to earn a regulated return. Tr. Vol. 2, pp. 230-31. It is found that MAC's arguments regarding the use of intangible assets are inappropriate and do not establish an improper subsidy.

58. MAC's allegation that Minnegasco has an incentive to overcharge its

utility customers is misplaced and ignores the realities of the current energy services market.

As Minnegasco testified, it must actively compete for new business with other gas and electric utilities, municipal operations, and the Minneapolis Energy Center. Additionally, active competition exists with other fuels, such as oil, propane and coal. Overcharging customers would put Minnegasco at a competitive disadvantage in the market and create the potential for loss of existing business and failure to obtain new business and service territories. Ex. 11, pp. 1-3.

59. Minnegasco offered evidence that combined operations do not result in increased costs of regulated operations. The Company argues that the only possible conclusion is that the benefits to ratepayers are even greater at this time. The financial benefits identified result primarily from the provision of emergency response and routine utility services, shared billing costs, and shared information services costs. Ex. 20, p. 62. Thus, while separation of regulated and non-regulated operations might be possible, 3-6. Minnegasco's testimony that union agreements, work rules and the joint use of facilities and some equipment (as well as employee benefit plans issues) could take up to two years to sort through in the event of separation was not credibly challenged. Tr. Vol. 4, pp. 660-664.

60. Customers benefit by Minnegasco's appliance service technicians' performance of both utility and non-regulated appliance service work. Since the first priority of appliance service technicians is to respond to emergency utility calls, one of two things would happen if Minnegasco were forced to divest itself of its appliance business. Utility rates would go up to pay for the number of additional utility employees to respond as quickly as the current dual work force responds, or the number of technicians available to respond to utility calls would decrease, which would mean longer response time for utility calls. This would be especially significant during emergencies, when thousands of customers may lose gas service. Ex. 10, pp. 5-6; Ex. 13, pp. 22-23. This evidence was unchallenged by cross-examination or conflicting evidence.

61. The Company cites other ratepayer benefits which flow from combined operations and contribute nothing to the cost of utility service, including the strategies used by Minnegasco's appliance sales operation to help ensure safety for all Minnegasco customers by maximizing the quality of appliance installations and operations. Such strategies include a requirement that all subcontractors carry proper licenses, possess appropriate liability insurance, obtain necessary community permits and comply with local codes in all

installations. Ex. 10, pp. 6-7.

No challenge was made to Minnegasco's testimony that Minnesota customers want Minnegasco to offer appliance sales and repair/maintenance services and that there has been and continues to be a strong demand for these Minnegasco products or that Minnegasco's offering of these products may be the only practical access to these services for some customers. Ex. 10, p. 2.

It is found that, for the reasons noted in this and preceding Findings, it is inappropriate to order severance of Minnegasco's regulated and non-regulated operations.

The_Company's_Cost_Apportionment_Manual_(CAM)_-_Specific_Allocation_Issues
Cost_of_Billing

62. The parties, most particularly the Company and the Department, disagree on a number of specific items in the Cost Apportionment Manual. Those issues are detailed below and in subsequent Findings.

The Billing Study apportionment method was prepared by Minnegasco to derive a factor to allocate costs incurred by Cost Centers 145-Inserters Operations, 161-Cash Management, 162-Customer Information System Controls and Cost Pool 298.4-Customers Information System, Corporate. DPS Exh. 30, p. 10.

63. Under the FCC's fully distributed cost principles, it is necessary to look first for a direct measure of cost causation to allocate billing costs. Neither Minnegasco nor the DPS could identify one. Therefore, following FCC principles, an indirect measure of cost causation should be identified. The Company contends that use of a billing study to allocate these costs is consistent with the universal practice among telecommunications companies subject to the FCC's Part 64 rules and regulations. The practice is to allocate customer billing and collection costs in accordance with a billing study. Ex. 2, pp. 5-6. (The DPS appears to agree that Cost Center 162, CIS Controls should be apportioned using a billing study. Ex. 36, p. 25.) Such a study serves as a directly attributable cost apportionment method for billing costs and an indirectly attributable apportionment method for cashiering costs, both of which comply with FCC cost apportionment principles.

64. Minnegasco performed a billing study to determine the appropriate amount of cashiering and bill inserter operating costs to be apportioned to regulated and non-regulated opera

MAC has suggested apportioning cashiering and inserter operating costs based strictly on the number of customers. This methodology does not comply

with FCC principles. There are more factors than only the number of customers that go into the cost of the bill and related postage. The amount of paper, the lines of print and the number of inserts included in the bill envelope all impact the cost. To apportion billing costs only on the basis of the number of customers is an over-simplification which should not be adopted. Ex. 18, pp. 51-52.

65. The Department raised two fundamental concerns. The first is related to the billing study methodology. The second concern is related to the application of this apportionment methodology to Cost Center 161 (Cash Management). DPS Exh. 36, pp. 25-26. MAC also disagreed with the Company's proposed method of apportioning these costs. The appropriateness of the methodology used to develop the billing study is examined first.

Minnegasco's billing study examines four costs included in Cost Center 145-Insertor Operations (bill form, envelopes, postage and insert machine) as well as Central Processing Unit (CPU) time to determine how to allocate the joint and common costs of billing customers. DPS Exh. 18, Schedule A, p. 2 shows a summary of Minnegasco's billing study. Roughly 95 percent of the costs used to develop the billing study allocator are associated with postage and envelopes, with nearly 90 percent associated with postage alone. Thus, while a complicated billing study examining all of these costs is not necessarily inappropriate, the method of allocating postage and envelopes drives this allocator.

66. The Company asserts that the size, strength, and quality of the envelope and therefore its cost is dependent upon the size and quantity of its contents. DPS Exh. 30, p. 10; Sch. HWS-2. The Company uses the square inches of space on the bill attributable to regulated and non-regulated services to allocate the envelope cost. Id., pp. 10 and 13.

Minnegasco also stated that:

The size and quality of Minnegasco's billing envelope is the same, regardless of whether it contains a bill with regulated-only charges, only non-regulated charges, or combined regulated and non-regulated charges.

Id., p. 11. It is the mailing of the bill that causes the cost. The envelope cost does not vary by content. The DPS argues that Minnegasco's method shifts the benefits derived from the efficiencies of integrated operations to its non-regulated subsidiary. The purpose of using a fully distributed cost study is to ensure that "if there are savings to be gained from integration of regulated and non-regulated ventures, those savings must be shared equitably with ratepayers in order to achieve regulated service rates that are just and

reasonable."

Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, FCC Docket No. 86-111, released February 6, 1987 at para. 39. Minnegasco Exh. 1, p. 10.

67. The Department method of splitting envelope costs equally for combined regulated and non-regulated billing is similar to the customer based allocator proposed by MAC. The cost of all envelopes for regulated bills only will be charged to regulated operations. The cost of all envelopes for non-regulated bills only will be charged to non-regulated operations. Because both non-regulated and regulated billing cause the cost of the mailing equally, the cost of these combined bills should be split 50-50 to regulated and non-regulated functions. Rather than splitting combined customers and counting each as one-half, MAC counts combined customers as two customers; one a gas distribution customer and the other an appliance service customer. MAC Exh. 24, Schedule 10. This has the impact of increasing the allocation factor, which is found to be inappropriate. The ALJ finds that the cause of the envelope cost for combined bills is

Minnegasco argues that the DPS's proposal that envelope and postage costs be divided equally between regulated and non-regulated operations for combined bills must be rejected because the methodology is inappropriate, given FCC principles of cost causation. Using the envelope to illustrate, its size is the same regardless of whether non-regulated services are on the bill. If an incremental cost standard were applied, no costs would be allocated to non-regulated operations. Since the envelope contains the bill, it is reasonable to use the direct measure of cost causation applied to the bill pages (i.e., the relative space on the bill used by regulated and non-regulated services) to indirectly attribute the cost of the envelope. Had a reasonable indirect measure not been available, FCC principles would have required the use of the general allocator. The Company asserts that the DPS's proposal fails FCC principles, ignoring indirect attribution and general allocation altogether and using instead an ill-conceived 50/50 allocation which has no causal basis. Ex. 2, p. 7.

The ALJ cannot agree. It is found that envelope costs for combined bills should be shared equally by the non-regulated operation. The bill portion for non-regulated services directly causes the envelope cost in equal measure to the bill portion for utility services, so a 50/50 sharing is reasonable and appropriate.

68. Like their argument with respect to envelopes, the Company believes that the postage component is based on the weight of the envelope and its

contents. Therefore, it calculates the postage component based on the contents or, more specifically, the number of pages. Mr. Schultz testified that the cost of postage constitutes a cost which is only affected if there is a substantial change in the weight of the contents mailed. Id., pp. 11-12. Both operations contribute equally in causing this cost on combined billings.

It is found that the same principles making appropriate and reasonable the DPS's 50/50 allocation proposal regarding envelopes and applicable to allocating postal costs on combined bills.

69. Mr. Schultz's position is supported by the fact that Minnegasco's postage cost does not vary each month based on the contents. Tr. Vol. 3, p. 531. Bill mailings to non-regulated only customers do not include the inserts referred to by Minnegasco. Id., p. 530. While these inserts supposedly affect the level of postage expense, Mr. Hagen testified that the postage cost for these bills is the same as its regulated mailings. Id., p. 531. Thus, the variable which affects postage costs is the number of bills mailed and not the contents.

The Company argued that it could reduce its postage cost by mailing the non-regulated bills with a postcard. Alternatively, it states that if the standard weight is exceeded, the additional postage would be incurred based on weight. Minnegasco Exh. 20, p. 4. This approach does not take into account the fact that the cause of the actual postage cost remains the act of mailing the bill for regulated and non-regulated operations, not the inserts. Moreover, as Mr. Schultz testified, there should be a substantial change in postage costs based on content if the Company's approach is used. Yet, the envelope and postage cost of mailing a regulated only bill, non-regulated only bill, or a combined bill is the same with or without inserts. This is different than, for example, the inserter costs which actually do vary by contents.

70. The ALJ finds that the apportionment method adopted for the billing function should include the method of calculating the envelope and postage components as proposed by the Department. Minnegasco's proposals for other billing costs, including apportionment of the bill form, inserts, machine and CPU time are found reasonable and should be adopted, except as noted below regarding Cost Center 161.

71. Minnegasco proposed that Cost Center 161 be allocated based on its bil

The DPS argues that the postage cost, the envelope cost, inserter time and CPU time used in generating the bill are not the same as the labor costs involved in processing the receipts. The tasks performed by the cashiering department relate to the number of remittances which, in turn, is based upon the number of customer accounts. The Department points out that when a remittance is for a combined non-regulated, regulated account, the processing

of the receipt is caused equally by both operations. The ALJ agrees. Thus, an apportionment based on the number of payments received, where combined payments are split equally, is found to be the most appropriate cost apportionment method. Since this should not vary significantly from the revised billing study method, the ALJ finds further that the billing study apportionment, as modified, is a reasonable proxy for the number of payments received.

Service_Technician_Minutes

72. The Cost Allocation Manual states that the ratio of productive utility minutes and productive non-utility minutes to total productive minutes of the Appliance Service Technicians' time is the basis for allocating on-the-job non-productive time. The Company initially deviated from its CAM and charged the evening stand-by portion of service technicians' on-the-job non-productive time directly to regulated operations. DPS Exh. 30, p. 34. In rebuttal testimony, Company witness Hagen testified that the reason for this deviation was that Minnegasco Appliance Service technicians respond only to emergency gas leak calls or no-heat calls during this time of day. Therefore, he proposed that during the six winter months, time should be reported as stated in the Cost Manual and that during the off-winter months this non-productive time be charged directly to the utility. Minnegasco Exh. 20, pp. 34-35. Mr. Hagen subsequently changed his testimony to agree with the Department's recommendation. Therefore, the ALJ finds that the appropriate allocation factor for on-the-job non-productive time, including evening stand-by time, is the ratio of service technician's productive time, using the service technician minute method.

73. Gas leak calls is another allocation problem involving the overlap of functions of the regulated gas distribution business and the non-regulated appliance service business. Minnegasco's Service Plus program advertises "Emergency gas leak services 24 hours a day, 365 days a year." DPS Exh. 35. When the Company responds to gas odor or leak calls and then fixes an appliance, it charges only the time for fixing the appliance to non-regulated activities. The phone calls are recorded as utility calls and all travel time is recorded as utility.

It is found that DPS's argument that travel time spent by appliance service technicians responding to gas leak calls (and the cost of the calls themselves) should be allocated in part to the appliance business has merit. All gas utility companies respond to gas leak calls, whether they have an appliance service business or not, and DPS agrees they should. DPS Brief, p. 21.

74. The Company maintains that because Minnegasco's Commercial Services brochure notes "Emergency gas leak service 24 hours a day, 365 days a year". emergency gas leak service is clearly a utility service and FCC cost causation principles require that it be recognized as such in cost allocations. The

fact that Minnegasco reminds commercial appliance service customers of the availability of its utility service does not change the character of that service or mean that response to emergency leak calls is a non-regulated service. The ALJ notes this argument, but not all service technician calls are for problems on the distribution system.

75. The DPS testified a portion of these costs should be assigned to the non-regulated service business because the calls to report a suspected gas leak come in part from Service Plus customers on the telephone number assigned to Service Plus.

76. This situation was compared to the FCC method of apportioning these costs. The FCC has a point of demarcation outside the home. The customer owns all of the wire inside the home as well as the customer premises equipment. Tr. Vol. 1, pp. 195-196. If it turns out that the problem occurs on the telephone distribution line, it is charged to the utility. If the problem occurs on the customer's side (the unregulated wire and equipment), the time of the job and the travel time are charged to unregulated operations. In the Matter of Implementation of Further Cost Allocation Uniformity, FCC Bureau Docket No. AAD 92-42, Order released July 1, 1993, at p. 5. (Exhibit 9.)

77. The ALJ generally accepts the idea that a natural gas utility should respond to gas leak calls. The DPS notes a the problem arises when its unregulated business also promotes itself as responding to gas leak calls. As a result, DPS witness Schultz recommended that an allocation is necessary because if a customer phones Minnegasco via an appliance service line (as opposed to dialing the utility emergency service phone line) to request a check for a suspected gas leak, the Company should assume the customer suspects a faulty appliance and record and charge the call and the cost of responding to it to appliance service. DPS Exh. 30, p. 34.

Mr. Hagen responded in rebuttal testimony that an individual suspecting a gas leak may call the first number they see whether its a billing number, credit number, Appliance Service number, or an emergency number. Minnegasco Exh. 18, pp. 35-36. He also testified that the ad referred to by Mr. Schultz should be ignored because customers are aware that they receive "24 a day, 365 days a year emergency gas leak response just by being a natural gas customer." Id., p. 35.

The DPS notes further that Mr. Hagen's testimony regarding which phone number a customer will call is "contradicted" by the testimony of Minnegasco witness Holmstoen. Mr. Holmstoen testified that customers who are Service Plus customers "tend to call the Service Plus [telephone] number if they detect gas odor." Tr. Vol. 2, pp. 317-318. Furthermore, the emergency gas leak service

is advertised as one of six major selling points for the service. The Department maintains this is more than simply a reminder that the customer receives this service just by being a gas distribution customer of Minnegasco.

78. This situation requires some allocation given the fact that Appliance Service is providing the same service as the utility side in this instance. The Department method of allocation assumes that if a customer calls the appliance service line, they are concerned about appliances, and uses this as the basis of cost-causation. Approximately 5,000 out of 30,000 calls either resulted in either piping or appliance repairs. DPS Exh. 17.

As an alternative, the DPS suggested that the cost of responding to a gas leak call be charged to the unregulated business if the gas leak was on internal piping or associated with an appliance. The DPS's alternative position is consistent with FCC precedent, and it is found appropriate for adoption. Tr. Vol. 1, pp. 169-170, 188-199. If the gas leak involves internal piping or is associated with the appliance, phone calls and travel time should be reported as non-utility.

79. MAC recommended that the cost of responding to gas odor calls be charged to the unregulated operations only if a repair of the internal pipes or an appliance is made. MAC Initial Brief, pp. 11-13. As noted in the preceding Finding, the Judge agrees with this recommendation.

Material_Handling_Costs

80. The Company's materials issues apportionment allocates the stores expense pool (Cost Pool 163) based on the ratio of the dollar value of parts and materials issued to each regulated and non-regulated operation to total dollar value of parts and materials issued through Minnegasco's warehouse. The costs being allocated are the e

The DPS argues that the Company's dollars charged method does not reflect the actual work activities that generate the costs. For example, the dollars charged method incorrectly assumes that the charge-out of a single \$90.00 module costs 45 times what it costs to charge out a single \$2.00 thermocouple even though, in actuality, the same functional activity of warehouse keeping and paperwork must be performed on each item in stores. DPS Exh. 30, p. 29.

81. Mr. Hagen testified that the activity involved in charging out a given issue is a cause of the costs of this cost pool. Tr. Vol. 2, p. 402. The Company supports the dollars charged method because its system is already programmed to make the allocation based upon dollars and it would be expensive

and burdensome to change this. Minnegasco Exh. 20, pp. 30-31. The Company failed to provide any record evidence on the level of costs involved in this Cost Pool. It also did not estimate how using an allocation based on charge-outs would impact costs if the DPS methodology were adopted. The Company's statements that this approach is not practical or cost-beneficial without any assessment of the financial impact and actual additional cost does not justify an apportionment method based solely on dollars charged. Thus, the ALJ finds it appropriate for the Commission to order the Company to develop and implement an allocator based on a combination of dollars charged and charge-outs.

Regulatory_Costs

82. MAC has taken the position that Minnegasco's regulatory, legal and administrative costs related to appliance program investigations are direct costs of Minnegasco's appliance sales and service operations and should be assigned directly.

Minnegasco has proposed to allocate the costs related to appliance program investigations using its general allocator. Minnegasco's Cost Apportionment Manual develops a general allocator which is used to allocate costs which are not apportioned based upon either direct attribution or indirect attribution. The general allocator is based upon the ratio of all expenses charged to regulated or unregulated operations as a percentage of all expenses charged to both regulated and non-regulated operations. Minnegasco witness James Farmer testified that the FCC has allowed the cost of compliance audits to be allocated using the general allocator. Mr. Farmer admitted that the FCC rule applies only to compliance audits and not to costs such as the cost of this docket. T186. Mr. Farmer also pointed out that use of the general allocator to allocate the costs of this docket would not necessarily determine the regulatory treatment of the costs allocated to the regulated utility. T131.

83. MAC witness Steven Fietek testified that the FCC rules apply specifically to the cost of the annual compliance audit required by the FCC of its larger carriers and that the FCC has not extended the rule beyond the cost of compliance audits. Ex.24, p.17.

84. DPS witness Schultz testified that the general allocator might be appropriate for allocating the costs of a general rate case, but this docket was initiated by a non-regulated question and complaint and should be more heavily weighted towards non-regulated operations because that is what is causing all these costs to be incurred. Ex.36, p.10.

85. In support of the Company's position that the costs for this docket should be allocated using the general allocator, Mr. Farmer cited the FCC's Joint Cost Order in Docket 86-111 in which the FCC determined that the costs incurred to comply with annual independent audit requirements be allocated based upon the general allocator unless a carrier is able to demonstrate that

there is an appropriate indirect attribution factor. Id., p. 26.

86. Department witness Schultz noted that the cause of this particular proceeding was a complaint that Minnegasco was subsidizing its non-regulated activities. That is, that the cause of this proceeding is whether non-

87. Minnegasco points out that it is the unchallenged industry practice for telecommunication companies to use the general allocator to allocate all compliance costs with FCC cost allocation rules. Ex. 2, p. 10.

The Company argues that MAC's proposal to allocate to non-regulated operations all costs of compliance with any Commission requirements related to cost apportionment is inconsistent with FCC principles and with practice. Ex.

2, p. 10. Likewise, it maintains the DPS's recommendation that costs incurred by Minnegasco related to this proceeding should be allocated more heavily toward non-regulated costs is not consistent with FCC principles. Ex. 2, p. 10.

88. It is found that Minnegasco's use of the general allocator to apportion regulatory compliance costs is generally appropriate and proper where no direct assignment is possible and no appropriate attribution factor exists.

However, the general allocator should not be adopted to allocate the cost of this docket as proposed by Minnegasco. It is found that simply defaulting to the general allocator in this case ignores that the costs of this proceeding are different from the annual audit costs considered by the FCC. This proceeding arose because of the Company's engagement in a non-regulated business, and the resultant costs should be assigned more heavily to those operations, as advocated by the DPS.

Calculation_of_the_General_Allocator

89. The FCC specifies that the general allocator is based on the regulated/non-regulated ratio of all expenses which can be directly assigned or attributed. Minnegasco Ex. 1, p. 11. The Department raised two concerns about

the Company's calculation of the general allocator. The first concern is that expenses of all Cost Centers that will be apportioned using the general allocator not be included in making the calculation of the ratio of total expenses. DPS Ex. 30, p. 27. The Department noted that the Company had proposed two different means of making this calculation. In its rebuttal testimony, Minnegasco witness Hagen agreed that the Company would make the calculation as shown in response to Department Information Request 193 (DPS Ex. 30, Sch. HWS-19). Minnegasco Ex. 20, p. 29. The ALJ find that this is an appropriate calculation method.

90. The second concern involves certain costs that should be removed before calculating total expenses. At Paragraph 78 of its Order_After

Reconsideration in Docket No. 86-111, the FCC stated:

"Costs of goods sold," when it is used in the sense of items purchased for resale, should be excluded from the expenses that contribute to the derivation of the general allocator. . . . We do not believe that costs of goods sold bears any relationship to the type of operating expense we had in mind in fashioning the general allocator.

91. The philosophy behind this decision is that the calculation of a general allocator should not include the cost of goods that are essentially "passed through the company to the final consumer." Ex. 18, p. 29. The record shows that "[s]uch costs are exactly what the FCC had in mind" in ruling that parts which are not manufactured by the Company subject to the cost allocation rules be excluded from the general allocator. Ex. 2, p. 12.

In its methodology for computing a general allocator, Minnegasco properly excluded the cost of gas purchased since it, likewise, does not affect the cost of operating the business. Ex. 2, p. 13. Similarly, appliance service parts are provided to customers on a pass-through basis; therefore, it is incorrect to include them in the general allocator since Minnegasco incurs no cost other than the purchase cost in providing these parts. Ex. 2, pp. 11-13. The Company maintains that the DPS, in including the cost of such parts, violates FCC requirements. The ALJ agrees, and it is found that appliance service parts costs "passed through" to the custom

Appliance_Sales_Employees

92. The Company apportions Cost Centers 670-Sales Director; 671-Field Sales MN; and 672-Appliance Center Supervisor using payroll hours. It is proposed that these cost centers will not use positive time reporting. Rather, the Company intends to use a fixed payroll allocation based on time studies of selected employees. DPS Ex. 30, p. 39.

93. The DPS argued for allocating all of certain Appliance Sales employees' time to the non-regulated business. This is inappropriate given FCC principles of cost causation since these Appliance Sales employees do receive and answer questions about utility service. Ex. 20, pp. 38-39. Thus, Minnegasco's performance of a time study to measure actual time spent on both regulated and non-regulated activities is appropriate.

An additional concern of the DPS is that employees in cost centers 670, 671 and 672 may perform non-regulated appliance sales activities even though no costs related to these cost centers are allocated to non-regulated operations. As Minnegasco testified, this issue was addressed in 1992 when Minnegasco

reorganized its Sales and Marketing areas to separate out the Appliance Sales function and directed utility sales employees not to promote non-utility appliance sales. Ex. 20, pp. 40-41. Thus, Minnegasco's proposed cost allocation methods should be adopted with respect to Cost Centers 670, 671 and 672.

Tax_Department_Costs

94. Minnegasco's proposed three-part factor (using regulated and non-regulated Pre-tax Income, Revenue and Plant) to apportion the costs of the Tax Department, which administers the income and other tax functions, is proper and complies with FCC principles. The FCC has addressed the question of allocation of the cost of income taxes, ruling consistently that pre-tax book income should be used to allocate the total cost of income taxes. It follows that pre-tax income serves as a reasonable indirect measure of cost causation to allocate the cost of the administrative activities associated with income taxes. Ex. 2, pp. 7-8.

95. The DPS criticized the component of the allocation factor which is comprised of the relative amount of pre-tax book income generated by regulated and non-regulated operations based on a concern that an activity which produced a loss would receive no allocation of cost.

Minnegasco uses the absolute value of any pre-tax losses in computing the income tax apportionment factor. The DPS's concern is misplaced. The alternatives proposed to Minnegasco's method by the DPS are not preferable to Minnegasco's method. Using revenues and expenses with the general allocator as proposed by the DPS is found to be less representative of the cause of income tax accounting than inclusion of pre-tax income as an apportionment variable. Ex. 20, p. 9.

Delinquent_Accounts_Receivable_Costs

96. The delinquent accounts receivable allocator is designed to apportion the payroll and expenses for staff who perform bill collections and make customers' payment arrangements. The Company's method apportions these costs based on the ratios of average year-end delinquent dollars outstanding for each regulated and non-regulated operation to total delinquent dollars. DPS Ex. 30, p. 19. DPS witness Schultz recommended using an average dollar per account method. This method attempts to recognize that the time spent on collections or setting up payment is not based solely on dollars but also the number of delinquent accounts. Id., p. 21.

97. Minnegasco testified that the number of delinquent accounts does not cause delinquent accounts collection costs. FCC principles require that the

factors which cause the cost be used to determine the apportionment factor. The Company points out that the dollar value of delinquent accounts triggers collection efforts, larger balances generally do require longer and more complicated efforts, and arrangements on gas accounts generally take longer to make than thos

It is found that the Company's proposed method for allocation of delinquent accounts receivable is appropriate.

Accounts_Payable

98. The Company proposed use of the general allocator for Cost Center 115- Accounts Payable. In responding to Department witness Schultz's recommendation that alternatives be considered, the Company proposed the use of total expense levels, less taxes, depreciation and payroll, to apportion costs.

Minnegasco Ex. 20, Sch. 16. Department witness Schultz believed that Accounts Payable functional activities are caused by the processing of invoices for payment and not the level of dollars paid. DPS Ex. 36, p. 24.

99. Mr. Hagen testified that using the number of invoices would be burdensome because for each invoice the Company would need to track which department ordered the material and then make an allocation to that invoice based upon the allocation factor used for that department so that the final allocator would be based upon a weighting of allocators of each invoice. Tr. Vol. 3, pp. 395-396. The Department agreed that this would be burdensome. However, it stated that this is not necessary. The Company could simply identify those invoices which are strictly regulated and strictly non-regulated and then apportion the common invoices on a 50-50 basis.

100. It is found that the methodology advocated by the Department in this instance is appropriate. Use of the number of invoices method, with common invoices allocated on a 50/50 basis, recognizes that the cost of making a combined payment is generated equally by regulated and non-regulated operations.

Departmental_and_Divisional_Apportionment

101. The departmental apportionment assigns the cost of the managers' or supervisors' cost centers based on an equal weighting of each reporting cost center's respective apportionment. DPS Ex. 30, p. 22. The divisional apportionment method is applied similarly to each vice-president's cost centers based on each of the departments that report to the respective vice-president. Id., p. 26.

Mr. Schultz recommended an allocation method based on a combination of dollars and employees in each cost center. It is reasoned that an allocator

based on both dollars and employees assumes that a manager's time will be driven based on the number of employees or the number of dollars in a reporting cost center rather than assuming that managers and vice-presidents split that time equally among each reporting cost center. *Id.*, pp. 22-23.

102. Minnegasco proposed to use the number of people directly reporting to a department or division head to allocate the payroll and expense costs of department and division heads. This method complies with FCC principles of cost causation and should be adopted. The amount of effort required by a manager to manage each person reporting directly to him or her should be relatively equal because of the experience and job levels of each employee. The Company argues that the DPS's belief that the departmental and divisional method should be calculated weighting the apportionment methods of the individual cost centers based on a combination of employees and expenses is misplaced since the total number of employees or the amount of expense for the department or division are not the cause of how a department or division head spends time. Ex. 20, pp. 17-20. The ALJ agrees with the Company's analysis of this issue and finds its proposed departmental and divisional apportionment of supervisory/managerial and vice-presidential time to be appropriate.

Direct_Payroll_Hours_Apportionment

103. The DPS expressed concern about the amount of payroll hours apportioned based on non-payroll expenses, listing 33 cost centers for which it believed other payroll related apportionment factors may exist. Ex. 20, Sched.«4.

The Company asserts that seventeen of the departments appropriately use a divisional or departmental apportionment method as described above, that ninety by the computer running the various computer applications using the CPU Seconds method is the best cost causative indirect attribution method to apportion these cost centers.

The apportionment of the remaining cost centers, the Tax Department, CIS controls and Cash Management are discussed in preceding Findings. It is found that none of the costs of the 33 cost centers identified by the DPS are allocated by an inappropriate method except as noted above, and none require a change in apportionment method merely because they are based on "non-payroll" expenses. Ex. 20, pp. 21-22. In this connection, it is noted that the ALJ agrees with the DPS regarding part of the apportionment for Cash Management. See Finding 71, *infra*.

104. When the DPS expressed concern over the amount and nature of

exception time reported by hourly employees in July 1993, Minnegasco responded by testifying in detail regarding each hour of such time. Ex. 20, pp. 23-28. The amount and nature of exception time reported in July by Minnegasco hourly employees is found to be appropriate and reasonable. See also Findings 35 and 36, infra.

Agreed_Upon_Issues

105. The DPS initially cited concerns with a number of methods to allocate costs which have been resolved. The DPS no longer opposes the methods proposed by Minnegasco with respect to the following:

a. Cost Center 147, Mail Services

The DPS originally proposed that the allocation method for cost center 147, Mail Services, should be based on the weighted average of employees working in general and administrative areas. This conclusion was based on a belief that operational personnel handle significantly less mail than general and administrative employees. The facts show otherwise. Approximately 75% of the mail handled by this cost center is internal mail. Minnegasco makes a significant number of mailings to all personnel, including a weekly and monthly newsletter, all types of payroll and employee benefit information, and other types of general and employee information. Ex. 20, p. 36. Therefore, the DPS agreed that Minnegasco's proposal to use all employees to apportion the costs of this cost center is appropriate. DPS Brief, p. 32.

b. Cost Center 114, Accounting and Tax Director

Minnegasco selected use of the general allocator to apportion this cost center for administrative ease. Ex. 20, p. 41. The Department does not oppose the use of the general allocator. DPS Brief, p. 34.

c. Number of Phone Calls

The DPS and Minnegasco agree that this method of cost allocation is appropriate for the cost centers for which it is used. Ex. 20, p. 33; DPS Brief p. 34. The DPS points out that continued review of the allocation method and calculation of the allocation factor is necessary, however, in apportioning cost centers 121, 122, 123 and 472 based on the number of phone calls answered.

d. Cost Per Copy Method

It was undisputed that it is appropriate to apportion monthly residual copy center costs using the general allocator as proposed by Minnegasco rather than the annual number of copies. Ex. 20, p. 10; DPS Brief, p. 35.

e. Personal Computer ("PC") Apportionment

The DPS and Minnegasco agree that this method is appropriate for the cost centers for which it is used. DPS Brief, p. 35. The Department has reservations, based in part on its discovery that some cost centers have more personal computers than employees, but acknowledges that further review and actual calculation can be addressed in the future.

f. CPU Seconds Method

The DPS and Minnegasco agree that it is appropriate to compute the CPU Second Factor on a monthly basis and to apply this result to the current month's CPU usage. DPS Brief, p. 36.

g. Lines of Print

The DPS and Minnegasco agree that informati

h. Service Technician Jobs

The DPS and Minnegasco agree that use of the number of service technician jobs method is appropriate for the cost centers to which this method is applied. The Department points out that if changes are ordered for the Service Technician Minutes apportionment method regarding gas leak calls, a similar adjustment is required on Service Technician Jobs apportionment.

i. Cost Center 148, Radio

The DPS raised a concern about the reasonableness of 78% of the costs in Cost Center 148 being apportioned to regulated operations. Costs in this center include those incurred performing electronic maintenance on company equipment, including radios, mobile data terminals, and Minnegasco's system used to collect temperature, pressure and gas flow information from the gas distribution system. Other duties performed by Cost Center 148 include control calibration and maintenance at Minnegasco's Peak Shaving facilities and maintenance of distribution system pipe locating equipment.

This, and the fact that electronic maintenance technicians use positive time reporting to charge time spent on each system, make it reasonable to apportion 78% of the costs in this cost center to regulated operations. Ex. 20, pp. 42-43. The DPS did not rebut Minnegasco's testimony. It is found that Minnegasco's proposed methodology must be adopted. The DPS's only remaining objection is that the CAM should be modified to note that positive time reporting is being used. DPS Brief, pp. 36-37. Minnegasco will make this revision.

Additional_Allocation_Issues

106. Vice President of Appliance Service

The FCC states that when time and expenses cannot be directly assigned or directly attributed to either regulated or non-regulated operations, costs should be apportioned using an indirect attribution method. In this case, it was not possible to determine the amount of time spent directly on non-regulated and regulated operations because the Vice President of Appliance Service's duties benefit both operations. Therefore, it is appropriate to apportion the salary of the Vice President of Appliance Service between regulated and non-regulated operations based on the apportionment of the time of those employees that directly report to him. The Vice President of Appliance Services' responsibilities include ensuring there is adequate staff to perform regulated work both on an emergency and scheduled basis and to ensure that personnel have adequate training to perform regulated functions. It would be unreasonable to charge all of his salary to non-regulated operations because he is responsible for significant regulated functions. Ex. 18, p. 88.

Consistent with FCC principles, Minnegasco identified the divisional apportionment method as appropriate for this officer because it reflects the nature of the management function. Ex. 18, p. 89. The ALJ agrees with the Company's analysis, and it is found appropriate to adopt the allocation proposed.

107. Cost Center 678, Director, Finance Planning and Analysis

The DPS questioned the allocation of this cost center. Minnegasco provided testimony addressing these questions which remains unchallenged. Ex. 20, p. 38. Thus, it is found that Minnegasco's cost allocation method should be adopted as proposed.

108. Cost Center 050, Centralized Corporate Expenses

The DPS stated it could not reach a conclusion regarding this cost center without additional information. Minnegasco therefore provided this information to the DPS. Ex. 20, p. 41. The DPS did not rebut this information; thus, it is found that Minnegasco's proposed methodology should be adopted.

109. Cost Centers 142, Production Services; 158, Technical Support; 311, Fleet Management

The DPS stated it could not reach conclusions regarding these cost centers without clarification of the apportionme

110. Cost Center 144, Telecommunication Services

The DPS stated it could not reach a conclusion regarding this cost center without additional information. Minnegasco therefore provided this information to the DPS. Ex. 20, p. 43. The DPS did not rebut this information; therefore, it is found that Minnegasco's proposed methodology must be adopted.

111. "Group 3" Apportionment

The DPS identified several cost centers that are apportioned using methods which are dependent on the apportionment methods of other cost centers. This fact is not a cause for concern since FCC principles require identification of indirect measures of cost causation when direct measures are not available. Ex. 20, p. 37. The DPS agrees the indirect methods are reasonable. Ex. 30, p. 38. It is found that when it is appropriate to change an underlying allocation, it is appropriate to change all affected factors as well.

Winter_Residential_Leak_Surveys_(WRLS)

112. The Commission's May 5, 1993 Order asked parties to address whether Minnegasco's Winter Residential Leak Survey (WRLS) program is prudently designed and operated. Minnegasco witness Holmstoen testified to the reasonableness of the WRLS program design, and agreed to redesign the program in accordance with a number of recommendations made by the DPS.

Minnegasco proposed to continue with that portion of the design of its previous WRLS program that has appliance service technicians conduct the leak surveys any time they enter the homes of Minnegasco's natural gas customers during the winter months. Minnegasco proposed a modification to the previous program so that any time during the WRLS season in which a qualified utility employee, such as a Construction and Maintenance employee, enters a customer's home, this employee would also perform winter leak surveys. The Company also proposed that, based on its sampling method, that each community served would receive a minimum of 10 percent coverage. The Company stated that it will make clustered, on-site, cold call visits until the minimum is reached. DPS Exh. 46, pp. 7-8.

113. The Department believes that the WRLS is a legitimate utility function. The Commission agreed that this was true in its November 10, 1992 Order. The Commission was, however, concerned with the prudence of the Company's program design.

The WRLS is one of four special winter leak detection surveys which are conducted because leaking gas from broken system pipes or fittings can migrate into customers' houses and other buildings. While gas normally migrates upward to the soil surface, when there is a frost cap this normal pathway is blocked and the gas will migrate to the point of lowest air pressure. Id, p. 3. The

primary purpose of performing the WRLS is to discover leaks that originate on the distribution system by detecting gas that has migrated into residences.

114. In the past, MAC argued that 90 percent of Minnegasco's gas leak checks would not be performed if the Company's non-utility appliance service program were separated from the regulated entity. Further, MAC argued that it is unnecessary to perform a leak check in a residence with an outdoor meter since the gas would escape at that point and not enter the residence. MAC Exh. 40.

With respect to MAC's first concern, Department witness Lowell concluded that in the event of separation, Minnegasco would create a substitute winter leak survey program and that the actual number of surveys would depend on that program. Id., p. 12. Ms. Lowell consulted with State Office of Pipeline Safety (OPS) staff regarding outside meters. OPS engineers felt that gas under higher pressure (which is the case with outdoor meters) could migrate faster and further and could enter a building through cracks in the foundation or through other pathways. DPS Exh. 46, p. 15. For the reasons noted above, the ALJ finds that the WRLS program is a legitimate utility function.

115. As DPS and Mi

116. The WRLS does detect leaks. During 1992, 119 leaks originating on the distribution system were detected. However, a low detection rate would not warrant scaling back or abandoning the program. Specifically, detection surveys cannot be judged as necessary or prudent solely by the number of leaks detected. The necessity for surveying must also be judged by the consequences that occur if a leak is not found. Ex. 13, p. 20; Ex. 46, pp. 15-16.

Minnegasco's WRLS is cost effective. Conducting these leak checks in part by using Appliance Service employees and utility employees when they are already at a residence avoids separate scheduling costs, separate dispatching costs, separate data entry costs, separate drive time costs and additional supervisory expenses. Ex. 13, p. 21-22.

117. Although MAC testified to the contrary, the WRLS is not preferential with respect to customers who have a Service Plus repair contract since it is a check designed to detect distribution system leaks. Additionally, any customer can request a leak check. Any detection (and correction) of a distribution system leak benefits all customers by avoiding the cost of an incident. Ex. 13, p. 14. Further, Minnegasco's redesigned WRLS achieves appropriate geographical coverage. Ex. 13, p. 16.

118. As recommended by the DPS, Minnegasco will calculate sampling rates based upon the actual number of individual residences in which a WRLS was

performed rather than on the total number of WRLSes performed. To calculate the 10% minimum coverage, Minnegasco will use the number of service lines in each community and the number of WRLS checks performed at unique residences within a community. Ex. 14, pp. 2-3.

119. Minnegasco agrees with the DPS that its recordkeeping system for WRLSes and customer requested leak checks can be improved and used to evaluate and refine the WRLS program. Minnegasco agrees to comply with the DPS's recommendation regarding WRLS information to be tracked. Ex. 14, pp. 3-4.

Minnegasco will keep detailed records showing the results obtained during the actual time reporting period for the WRLS and for use as a basis of subsequent cost decisions. Ex. 14, p. 4.

120. Minnegasco proposed to reevaluate the time it takes to conduct a winter leak survey. Previously, the Company charged a fixed time of 10 minutes for each survey conducted based upon a time study which resulted in an average time of 8.45 minutes. Minnegasco explained that these are surveys where no leaks were detected, none were in apartment buildings, and no snow was on the ground. The Company adjusted the number up to 10 minutes based on these factors. Even if leaks detected were assumed to take one hour, the average WRLS would be 8.69 minutes. Id., pp. 16-17. However, the Company should not record any gas leak repair as part of the WRLS. It is noted that if the time involved is to trace to the source of the leak, then an average of one hour results in a conservative estimate of the average time necessary to perform the WRLS.

121. Department witness Lowell conducted an investigation as to the need for repeat checks, particularly those close to the date of the initial check. OPS engineers stated that leaks can develop quickly. Because the chance of a leak developing is essentially random, the risk of a leak developing on a given pipe one or two days later is the same as in the initial visit. One engineer likened the random nature of leaks to flipping a coin. On each individual coin flip, the probability of getting heads is 50 percent, no matter how many times the coin is flipped. DPS Exh. 46, p. 18. Ms. Lowell estimated that the direct cost of all repeat checks is \$161,800, based on the Company's initial information. The revised direct cost estimate of allowing all repeat checks based upon the data provided in Minnegasco Exh. 52 is \$93,720.

Ms. Lowell compared the initial higher cost to the qualitative benefits from the additional safe

122. In addition, the Department recommends that the Company keep track of whether a leak was detected on a repeat check and the number of days after the initial check that the leak was detected. This additional requirement can provide the Commission with useful information in re-evaluating the

reasonableness of including repeat checks in the future. The ALJ agrees with these record-keeping recommendations.

123. MAC witness Derick Dahlen testified that the Minnegasco Winter Residential Leak Survey program was poorly designed because its sampling methodology was flawed and it discriminated against ratepayers that did not purchase Minnegasco's non-regulated Service Plus program. Mr. Dahlen explained that Minnegasco's WRLS program is not based upon sampling, but that a leak assessment is performed whenever a qualified Minnegasco employee is inside the customer's house when there is at least one inch of frost in the ground. MAC maintains that the WRLS program is flawed because there is no survey design. Minnegasco had no studies, statistics or historical data to show the relationship between the risk of incident and the frequency of leak surveys. Ex. 38, Sch.9. Minnegasco's revised Analysis_of_Leak_Checks_by_Region, a late filed exhibit, shows the survey percentages for 1992 range from 0% to 27% of services for different cities. Minnegasco provided no justification for this difference in survey percentages, MAC notes.

124. Mr. Dahlen also testified that Minnegasco's WRLS discriminates against ratepayers that do not purchase Service Plus from Minnegasco, because Service Plus customers receive more inspections than do ratepayers who do not purchase Service Plus. Ex.38, p.13. All the leaks found on the distribution system in 1992 through WRLS checks were found by Appliance Service Technicians incident to an appliance service call. This occurs because it is the Appliance Service Technicians who do the leak surveys whenever they are in a customers house, and they are in the homes of appliance service customers doing appliance service when the leak surveys are performed. Mr. Dahlen suggested that the leak surveys could be done by meter readers at less expense and with more uniform coverage than the existing leak survey program using Appliance Service Technicians. Ex.38, p.14. Mr. Dahlen testified that a well designed WRLS program would be based upon sound sampling techniques which would balance the number of surveys with the cost of sampling and would not discriminate against customers that did not participate in Service Plus.

125. It is found that the Company's WRLS program, designed as proposed by Mr. Holmstoen in agreement with recommendations of the Department, is reasonable and appropriate for implementation. The redesigned WRLS program addresses all appropriate design concerns raised by MAC.

126. It is found that Minnegasco's redesigned WRLS does not grant a preference in service to its Service Plus customers because any customer on the Company's distribution system can request a leak check, and detection and correction of a leak benefits all customers by avoiding the cost of an incident such as an explosion.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. The ALJ and the Minnesota Public Utilities Commission have jurisdiction over the subject matter of this hearing pursuant to Minn. Stat. §§ 14.57-14.62, Ch. 216B, and Minn. Rules 1400.5100 - 8300 and 7830.0100 - 4400.

2. The Commission gave proper notice of the hearing in this matter, has fulfilled all relevant substantive and procedural requirements of law or rule, and has the authority to take the action proposed.

3. Any of the above Findings of Fact more properly considered Conclusions of Law are hereby adopted as such.

4. Under the Company's current cost allocation practices, implemented on July 1, 1993, it is premature to d

5. The methodology reflected in the Company's Cost Apportionment Manual, when applied properly, should not permit the existence of any cross-subsidies between regulated and non-regulated operations.

6. The allocation system implemented by the Company on July 1, 1993, is structured so that, given sufficient data, it can report information in a manner that makes Minnegasco's books and records comprehensible to and auditable by persons outside the Company. It is not necessary to perform an audit to determine that a Cost Apportionment Manual is auditable.

7. Under the Federal Communications Commission (FCC) principles Minnegasco has been ordered by the Commission to follow, the ultimate determinant of allocations is cost causation. The Commission's November 10, 1992 Order requiring Minnegasco to adopt FCC cost allocation principles did not direct the Company to do anything more than follow the FCC's hierarchy of assigning and allocating costs.

8. The FCC's fully-allocated approach to apportioning costs, as applied to a gas utility operating both regulated and non-regulated businesses, allows for participation by ratepayers in available economies of scale and an equitable sharing of the benefits of combined operations. This approach goes beyond the incremental cost approach, which is enough in itself to prevent cross-subsidies.

9. It is appropriate for Minnegasco to follow FCC principles, rules and decisions whenever practical and applicable in developing cost apportionment factors. The Company's decision-tree approach and factors used to select apportionment methods are appropriate and consistent with the Commission's

Order to follow FCC principles.

10. Minnegasco's Cost Apportionment Manual complies, in form and content, with relevant and applicable FCC rules and principles of guidance.

11. It is appropriate to order Minnegasco to take action ensuring its reporting procedures are subject to appropriate internal controls so that reporting errors such as that involving the number of Winter Residential Leak Surveys performed in 1992 can be avoided.

12. It is appropriate to order the Company to take measures to detect and correct errors in the coding of expenses, which errors are inevitable given implementation of a new cost allocation system after July 1, 1993.

13. It is appropriate to order the Utility to attempt to change its time reporting practices so that "normal" exception time is not reflected as exception time. If this cannot be done the Company's CAM should identify Cost Centers that will report larger amounts of "normal" exception time clearly and record it so that such time can be quantified readily.

14. It is appropriate to order the Company to clarify the steps to be taken to adjust or "true up" accounts or Cost Centers whose actual results are different than assumed in the CAM with respect to dollars spent on regulated or non-regulated activities.

15. It is appropriate to order the Company to review its ability to assign costs directly on a continuing, ongoing basis.

16. Sufficient controls exist in the Company's cost apportionment methods to minimize errors in cost reporting.

17. There is no one right method for allocating costs. It is appropriate to engage in reasoned decision making regarding all disputed allocation issues, focusing first on the actual work activity to be allocated.

18. Minnegasco's allocation system applies the general allocator to less than 2% of the Company's non-gas costs, a relatively small percentage of total costs that indicates its cost allocation system is effective.

19. The fact that results differ after a change in allocation methodology does not, of itself, prove the existence of a subsidy under either of the two methods being compared.

20. Through the Direct Testimony of Daniel Hagen, Minnegasco has refuted MAC's allegations of subsidies to its non-regulated business for 1991.

21

22. As a result of Conclusions 20 and 21, the record fails to establish that Minnegasco subsidized its unregulated operations with improperly-allocated ratepayer funds for any period prior to implementation of its new Cost Apportionment Manual on July 1, 1993.

23. The intangible assets MAC contends should be paid for in part by Minnegasco's unregulated operations are not part of the Company's utility rate base. Since ratepayers supply no funds in support of such assets, MAC's allegation of a subsidy of the unregulated business by the regulated operation with respect to these assets is unfounded.

24. MAC's allegation that the Company has an incentive to overcharge its regulated utility customers to subsidize its unregulated operations has not been established.

25. It is appropriate to reject MAC's proposal for the Public Utilities Commission to order a severing of Minnegasco's regulated and non-regulated operations.

26. It is appropriate to reject MAC's proposal to apportion the costs of billing only on the basis of numbers of regulated and non-regulated customers.

27. It is appropriate to divide equally between regulated and non-regulated operations the envelope and postage costs for bills reflecting both types of services (combined bills) as proposed by the DPS.

28. Minnegasco's proposals for apportionment of billing costs other than envelope and postage costs on combined bills are reasonable and it is appropriate to adopt them. These costs include apportionment of the bill form, inserter machine and CPU time.

29. It is appropriate to divide equally between regulated and non-regulated operations the cashiering costs involved for bills reflecting both types of services (combined bills), as proposed by the Department.

30. The appropriate allocation factor for on-the-job non-productive time, including evening stand-by time, for Appliance Service Technicians is the ratio of their productive time, using the service technician minute method, as advocated by the DPS.

31. If a gas leak call involves internal piping or is associated with an appliance, it is appropriate to charge the phone call reporting a problem and travel time to Minnegasco's non-regulated operations, as advocated (in the alternative) by the Department and by MAC.

32. It is appropriate to order Minnegasco to develop and implement an allocator based on a combination of the dollars charged and charge-outs methodologies for apportioning its warehousing costs (Cost Pool 163).

33. The Company's proposal to assign regulatory costs in accordance with the general allocator is appropriate in most instances, such as for general rate cases, but is inappropriate with respect to assigning the costs of this docket. This case arises because of the Company's involvement in a non-regulated appliance sales and service operation, and it is appropriate to assign its costs more heavily than would the general allocator to the unregulated business, in accordance with the recommendation of the DPS. Adoption of MAC's recommendation to assign all costs to the non-regulated business is inappropriate because it gives too much weight to the non-regulated activities.

34. In developing its general allocator, it is appropriate for the Company to make the calculations shown in response to the Department Information Request 193.

35. It is appropriate to exclude from the general allocator appliance service parts provided to Service Plus customers which are accounted for on a pass-through basis.

36. It is appropriate to adopt Minnegasco's cost allocation methods with respect to Appliance Sales Employees (Cost Centers 670, 671 and 672).

37. It is appropriate to adopt Minnegasco's proposed three-part factor to apportion the costs of its Tax Department.

38. The Company's proposed method for allocation of delinquent accounts receivable is appropriate for adoption.

39. It is appropriate to alloc

40. It is appropriate to adopt the Company's proposal for departmental and divisional apportionment of supervisory/managerial and vice-presidential time.

41. Because many Cost Centers are apportioned using methods dependent on the apportionment methods applied in other Cost Centers, when it is appropriate to change an underlying allocation, it is also appropriate to change all affected factors.

42. Minnegasco's Winter Residential Leak Survey (WRLS) program is a legitimate utility function.

43. It is appropriate to continue utilizing repeat leak checks as part of the Company's WRLS program.

44. The Company's redesigned WRLS program adopting many of the recommendations of DPS witness Fran Lowell, is designed prudently and will operate efficiently if operated according to its design.

45. All other issues have been resolved or rendered moot by circumstances.

THIS REPORT IS NOT AN ORDER AND NO AUTHORITY IS GRANTED HEREIN. THE PUBLIC UTILITIES COMMISSION WILL ISSUE THE ORDER OF AUTHORITY WHICH MAY ADOPT OR DIFFER FROM THE FOLLOWING RECOMMENDATIONS.

Based upon the foregoing Conclusions, the Administrative Law Judge RECOMMENDS that the Minnesota Public Utilities Commission issue the following:

ORDER

1. The Company's Cost Apportionment Manual implemented on July 1, 1993 and as modified in accordance with the above Findings, is an appropriate response to the Commission's November 10, 1992 Order to adopt FCC principles of cost allocation. The methodologies utilized in the Cost Apportionment Manual are adopted, as modified, for use and further examination in the Company's general rate case filed effective December 9, 1993.

2. Minnegasco, the Department of Public Service and all other interested parties are ordered to develop appropriate reports and necessary procedures for updating the Company's Cost Apportionment Manual in accordance with the above Findings.

3. The Company's Winter Residential Leak Survey program, modified in accordance with the above Findings is adopted.

4. The Complaint of the Minnesota Alliance for Fair Competition (MAC) against Minnegasco is dismissed.

Dated this 5th day of January, 1994.

/s/_Richard_C._Luis_____

RICHARD C. LUIS
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. § 14.62, subd. 1, the commission is required to serve its final decision upon each party and the Administrative Law Judge by

first class mail.

Reported: Shaddix & Associates
Lori A. Case, Court Reporter

7-2500-7892-2
PUC Docket No. G-008/C-91-942

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Complaint of
the Minnesota Alliance for Fair
Competition (MAC) Against Minnegasco,
a Division of Arkla, Inc.

ORDERS ON MOTION
TO COMPEL DISCOVERY

On September 17, 1993, Minnegasco filed with the Administrative Law Judge a Motion to Compel Discovery Responses from the Minnesota Alliance for Fair Competition (MAC) to Minnegasco Data Requests 4, 5, 6, 9, 10, 13, 18, 19 and 20. MAC filed a written reply on September 30, 1993. The parties waived further oral argument.

Minnegasco (Company, Utility) is represented in this matter by Miggie E. Cramblit, General Counsel, Minnegasco, 201 South 7th Street, Minneapolis, Minnesota 55402, and Paul T. Ruxin, Jones, Day, Reavis and Pogue, North Point, 901 Lakeside Avenue, Cleveland, Ohio 44114. The Minnesota Alliance for Fair Competition is represented by James D. Larson, Wurst, Pearson, Larson, Underwood and Mertz, 1100 First Bank P

Having taken under advisement the parties' arguments and the balance of the record herein, the Administrative Law Judge hereby makes the following:

ORDERS

Minnegasco's Motion to Compel Responses from MAC is hereby GRANTED IN PART and DENIED IN PART, as follows:

MAC shall provide a response to Minnegasco Requests 5 and 13 with all deliberate speed; and

The September 17, 1993 Motion by Minnegasco to compel responses from
MAC to Minnegasco Requests 4, 6, 9, 10, 18, 19 and 20 is DENIED.

IT IS FURTHER ORDERED that the deadline for additional testimony resulting
from the information made available to Minnegasco by operation of this Order
is
October 26, 1993, the deadline for filing Surrebuttal Testimony herein.

Dated this 11th day of October, 1993.

/s/_Richard_C._Luis_____

RICHARD C. LUIS
Administrative Law Judge

MEMORANDUM

Data Requests 4, 5, 6 and 10 were or should have been answered in MAC's Direct Testimony filed on September 23, 1993. The Administrative Law Judge has reviewed that filing but not with sufficient detail to determine whether the parties agree regarding the definition of terms listed at Request 5. Since understanding of the other side's definitions of those terms is important, compliance with Request 5 has been ordered. If Minnegasco is uncertain, in light of MAC's latest testimony and considering the entire record, of MAC's interpretation of these terms, its counsel should so inform counsel for MAC and MAC's counsel should provide the interpretation in time for the Company to prepare its October 26 filing.

Request 9 asks for detailed information regarding leak survey and cost allocation practices of MAC members. The Administrative Law Judge is mindful of the Commission's concern for determining appropriate allocation and leak survey methodologies to apply at Minnegasco, encompassing a need to examine alternative methods or operations if Minnegasco's are found wanting. However, ordering compliance with Request 9 improperly and belatedly shifts the focus of the inquiry away from Minnegasco and onto entities whose competitive environment and methodologies are immaterial to the subject matter of this docket. As noted in MAC's response, its members are actually trade associations. It is presumed such entities do not conduct gas leak surveys or engage in cost allocation in a retail setting. The individual members of these associations may be so engaged but, as counsel for MAC notes, those businesses are not individual parties to this case and it has not been demonstrated by Minnegasco that disclosure of their cost allocation systems and safety programs

is reasonably likely to lead to the discovery of admissible evidence in a case concentrating on the methodologies of a public utility operating a retail sales and service business. Minnegasco's argument for discovery - that the "fairness" of its practices are at issue and that fairness can be determined only by comparison to the practices of its competitors, is strained and does not convince the Administrative Law Judge of a need to compel the information sought. Any evidence concerning alternative methodologies and practices should come from discovery related to other utility companies' procedures, which discovery has been ordered or conducted earlier.

It is appropriate for MAC to disclose to Minnegasco in detail the connection (if any) between the methodology used to compute alleged subsidies and FCC cost allocation principles. MAC's initial response, that the cost allocation principles stated in its January 20, 1993 Report are "consistent" with the FCC principles, should be backed up with specificity and detail in time for Minnegasco to analyze the response and prepare any responsive evidence by October

Minnegasco Request 18 asks: "What is MAC's definition of 'complies' with FCC principles?", a question to which MAC objected as being overly broad and ambiguous. The Judge agrees with MAC. It is assumed that "compliance" with FCC principles is a somewhat fluid concept within the context of this case, something that may vary in meaning depending on a particular methodology in comparison to a particular FCC principle. The word will be applied most appropriately in issue-by-issue analysis at varying levels of specificity and detail in countless instances as this matter proceeds. Standing alone, considering the key role "compliance" will probably play herein, asking for a definition of the concept is, as MAC objected, viewed by the Administrative Law Judge as overly broad and ambiguous. As stated by the Commission in its Notice of Hearing, at issue are whether subsidies are occurring, what to do if they are, and whether application of FCC cost allocation principles make Minnegasco's allocations comprehensible and auditable. The inquiry goes beyond whether the Company "complies" with FCC principles, into a consideration of whether FCC principles are the proper "roadmap" to lead to the actual goal of a comprehensible, auditable system. Given such considerations, the materiality of a specific definition of "compliance with FCC principles" is doubtful.

Regarding Request 19, MAC has chosen to respond to the inquiry regarding advantages to the Company's utility operations from combining its regulated and non-regulated operations by saying no net advantage exists. MAC responded further, in attempt to demonstrate in its filings (including its September 23 Direct Testimony) that "whatever advantages the Company can claim are outweighed by the disadvantages identified by MAC. . . ". The Administrative Law Judge interprets this response to say that MAC tacitly acknowledges advantages to combined operations (in fact the Public Utilities Commission seems to agree in its Orders to date, it just seeks that those advantages be shared in a way equitable to ratepayers, shareholders and customers) but that they are not worth the actual and potential abuses by way of subsidy from

ratepayers to appliance sales and service. A major argument made by MAC is that the "disadvantages" are so great that the Utility should be ordered to split off the sales and service operations. As to "analysis and supporting workpapers to support MAC's conclusion" in this regard, the Administrative Law

Judge is persuaded that MAC's January 20, 1993 Reports, its comments in earlier

Complaint dockets, its responses to Information Requests herein and its Direct

Testimony filed September 23, 1993 stand to answer that part of the inquiry. It is noted that workpapers used to support prefiled testimony are discoverable.

Request 20 asks for "all workpapers, studies or analysis of Minnegasco's July 2, 1993 testimony and exhibits filed in this proceeding". MAC objected on

grounds of over-broadness, seeking information not relative to the subject matter of the case, seeking information that will not lead to the production of

admissible evidence and the seeking of documents protected from disclosure by the attorney-workproduct [sic] privilege.

The Administrative Law Judge agrees with MAC. If Minnegasco seeks workpapers supporting the filed testimony, it could request them (if they have

not already), and they are discoverable. However, the question in Request 20 implies that Minnegasco wants access to another party's mental impressions formed upon receipt of its (Minnegasco's) filing - information that strikes the

Judge as documents prepared in anticipation of litigation or for trial generally protected as work product of attorneys and other persons covered by Rule 26.02(c) of the Minnesota Rules of Civil Procedure. An exception to the Rule is found if the party seeking the information (Minnegasco) makes a substantial showing it is unable without undue hardship to obtain the substantia

RCL